

Message Text

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C O N F I D E N T I A L SECTION 1 OF 2 LISBON 499

DEPT PASS TREASURY FOR UNDER SECRETARY YEO AND SYVRUD

E.O. 11652: GDS
TAGS: EFIN, ECON, PO
SUBJ: FINANCIAL ASSISTANCE FOR PORTUGAL

REF: (A) STATE 11282, (B) LISBON 363

1. ECONOMIC COUNSELOR AND I MET MORNING OF JANUARY 18, AT THEIR REQUEST, WITH PRIME MINISTER SOARES, MINISTER OF FINANCE MEDINA CARREIRA AND CENTRAL BANK GOVERNOR SILVA LOPES. PORTUGUESE AUTHORITIES EXPRESSED GRAVE CONCERN THAT BASIC ASSUMPTIONS UNDERLINING AGREEMENT REACHED DECEMBER 31 BY U.S. AND PORTUGUESE DELEGATIONS MAY HAVE BEEN DISSIPATED BY ATTITUDES EXPRESSED SUBSEQUENTLY BY IMF AND BANK OF INTERNATIONAL SETTLEMENTS. THEY CONCUR THAT TEXT OF AGREEMENT AS PRESENTED BY TREASURY IS ACCURATE REFLECTION OF TECHINCAL AGREEMENT REACHED DURING VISIT OF UNDER SECRETARY YEO. THEY FEAR, HOWEVER, THAT CHANGE IN ATTITUDES OF INTERNATIONAL INSTITUTIONS WOULD MAKE AGREEMENT INOPERABLE. THEY ARE ANXIOUSLY AWAITING FOR REPORT ON YEO'S DISCUSSION WITH BIS, STRONGLY PREFERRING TO USE THAT INSTITUTION, RATHER THAN ANOTHER AGENT, BECAUSE OF POLITICAL CONSIDERATIONS. THEY WILL ALSO PRESS THEIR NEGOTIATIONS WITH THE IMF.

2. PORTUGUESE AUTHORITIES RAISED THREE POINTS WHICH
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THEY WOULD APPRECIATE TREASURY TAKING INTO CONSIDERATION:
A. DURING THE DECEMBER NEGOTIATIONS BOTH DELEGATIONS CONCURRED THAT AGREEMENT WOULD REFER TO USG INTENTIONS TO HELP ORGANIZE A \$1.5 BILLION CONSORTIUM. GOP OFFICIALS REQUEST THAT SPECIFIC REFERENCE BE MADE TO THAT INTENTION IN COVERING LETTER FROM SECRETARY SIMON TO GOVERNOR SILVA LOPES.

B. ANCILLARY AGREEMENT NUMBER 2, PARA II, EXPLICITLY PROVIDES FOR THE APPROVAL BY THE SECRETARY OF THE TREASURY OF PORTUGAL'S FISCAL, MONETARY AND OTHER ECONOMIC POLICIES BEFORE DRAWINGS UNDER THE SWAP ARRANGEMENTS CAN BE EFFECTED. PORTUGUESE AUTHORITIES BELIEVE THAT THIS PROVISION IS BASICALLY UNNECESSARY SINCE DRAWINGS ARE TO BE GUARANTEED EITHER BY PENDING IMF DRAWDOWNS OR BY FUTURE GOLD SALES. THEY REQUEST, THEREFORE, THAT THIS PROVISION BE ELIMINATED OR, AT LEAST, BE MODIFIED IN ORDER THAT IT BE EXPRESSED IN MORE GENERAL TERMS SIMILAR TO THOSE PROVIDED IN PARA 5 OF REF A.

C. PRIME MINISTER HAS DECIDED NOT TO SUBMIT AGREEMENT TO THE PORTUGUESE NATIONAL ASSEMBLY. HE AND FINANCE MINISTER WISH TO ASSURE, THEREFORE, THAT AGREEMENT CLEARLY INDICATES THAT BANK OF PORTUGAL IS THE PORTUGUESE AGENT IN THE SWAP TRANSACTIONS. EXPLICIT REFERENCE TO PORTUGUESE MINISTRY OF FINANCE GUARANTEE OF THE AGREEMENT WOULD NECESSITATE SUBMISSION TO THE NATIONAL ASSEMBLY FOR APPROVAL.

3. COMMENT: THERE ARE SEVERAL PROBLEMS WHICH HAVE GIVEN RISE TO CURRENT PORTUGUESE APPREHENSION ABOUT THE LOAN, NOT ALL OF WHICH ARE READILY VISIBLE TO THE EYE. AT THE CONCLUSION OF DECEMBER NEGOTIATING SESSIONS WITH YEO, EVERYBODY, INCLUDING HIS OWN MINISTERS, TOLD SOARES THAT ISSUES HAD BEEN RESOLVED, BUT DID NOT BRIEF HIM FULLY ON TERMS. WHEN HE TOLD YEO GOP WAS OPPOSED TO DEVALUATION AT THE PRESENT TIME, AND LATTER AGREED THAT CONFIDENTIAL

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BENEFITS WOULD BE LOST UNLESS PROPER GROUNDWORK HAD BEEN LAID, SOARES ASSUMED THIS ISSUE DID NOT ARISE IN NEGOTIATIONS. NEWS THAT DEVALUATION WAS PRECONDITION FOR FIRST CREDIT TRANCHE APPARENTLY CAME AS A SHOCK AND CAUSED HIM TO REOPEN ENTIRE LOAN PACKAGE, SOMEWHAT TO THE DISTRESS I SUSPECT OF HIS FINANCE MINISTER AND CENTRAL BANK GOVERNOR. MUCH OF TODAY'S CONVERSATION CENTERED AROUND THE NEED FOR USG TO EXHIBIT POLITICAL UNDERSTANDING, WHICH ARGUMENTS I ESSENTIALLY REJECTED BY FOCUSING ON NEED FOR GOP TO ENGAGE ITSELF WITH IMF AND TO TIGHTEN UP ITS ECONOMIC POLICY, A NEED THAT SOARES HAS CONSISTENTLY RECOGNIZED.

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C O N F I D E N T I A L SECTION 2 OF 2 LISBON 0499

DEPT PASS TREASURY FOR UNDERSECRETARY YEO AND SYVRUD

4. GOP HAD BEEN LED TO BELIEVE BOTH BY ITS CONVERSATIONS WITH IMF AND WITH TREASURY OFFICIALS THAT FIRST CREDIT TRANCHE WOULD BE RELATIVELY EASY TO NEGOTIATE. IT HAD ALSO COME TO BELIEVE THAT BIS WOULD ACCEPT GOLD SALE FORMULA DEvised BY TREASURY DELEGATION. WHILE IT IS ACCURATE TO SAY THAT BIS WAS NEVER A PART TO THE AGREEMENT, IT IS EQUALLY ACCURATE TO SAY THAT THE ASSUMPTIONS UNDERLYING CERTAIN OPTIONS OF THE AGREEMENT WERE BASED ON ASSESSMENTS OF THE POSITION THESE TWO ORGANIZATIONS WERE EXPECTED TO TAKE.

5. FINALLY, AND PERHAPS MOST SIGNIFICANTLY, SOARES HAS RECEIVED WORD FROM SOMEWHERE THAT THE CONSORTIUM LOAN HAS LITTLE CHANCE OF SUCCESS. HE HAS THUS COME TO VIEW THE \$300 MILLION LOAN AS AN EFFORT TO PRESSURE HIM PREMATURELY INTO DEVALUATION AND GOLD SALES WITHOUT ANY GUARANTEE THAT HE WILL HAVE THE POLITICAL BREATHING SPACE OFFERED BY THE \$1.5 BILLION LOAN.

6. MOST OF THESE PROBLEMS ARE SIMPLE PROBLEMS OF COMMUNICATION AND STYLE, BUT VIEWED FROM HERE THEY ARE REAL. THEY CAN BE RESOLVED IF WE MAKE SOME OF THE WORDING CHANGES SUGGESTED ABOVE, IF UNDER SECRETARY YEO IS SUCCESSFUL IN HIS MEETING WITH THE BIS, AND IF
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WE ASSURE THE PORTUGUESE THAT WE ARE TRYING TO BE HELPFUL WITH THE IMF. (SOARES OBVIOUSLY THINKS WE ARE BEHIND THE IMF'S FIRM STANCE ON A FIRST CREDIT TRANCHE AGREEMENT.) I TOLD SOARES AS CLEARLY AS I COULD THAT TREASURY HAD EXTENDED ITS

MANDATE TO THE LIMIT IN ORDER TO MEET PORTUGAL'S NEEDS
AND THAT I SAW NO PROSPECT FOR MORE ADVANTAGEOUS
ARRANGEMENTS. TO THE CONTRARY, ANY TAMPERING WITH THE
FUNDAMENTAL ASPECTS OF THIS ARRANGEMENT COULD PREJUDICE
OUR JOINT EFFORTS ON A CONSORTIUM LOAN. WE WOULD, I
SAID, CONSIDER THE ISSUES HE HAD RAISED, BUT IT WAS
IN EVERYONE'S INTEREST TO GET THE \$300 MILLION LOAN
SIGNED ASAP. SOARES SUGGESTED WE MEET AGAIN TOMORROW
TO ASSESS RESULTS OF YEO'S DISCUSSION WITH BIS.
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